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EFFECTS OF SHELTER ALLOWANCES ON RENTS AND HOUSING CONDITIONS

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This paper discusses three points relating to the proposal for a national shelter allowance program:

1. **The Nature of the Rental Housing Situation.**
   What are the problems of the rental sector in Canada today?

2. **The current shelter allowance/rent decontrol package.**
   Exactly what is this package being proposed by a number of organizations such as the Economic Council of Canada and the Canadian Home Builders Association (formally HUDAC)

3. **The feasibility and desirability of this policy package.**
   How economically and politically feasible is this proposal and how socially desirable is it? What impacts might it have on the existing rental stock and who is likely to benefit?

A shelter allowance is an income support measure tied to the cost of shelter. It is generally defined as:

> "a direct cash transfer made regularly to families or individuals to enable them to afford adequate housing of their own choice from existing stock; the amount of the allowance is based on income and housing costs, and is used solely for meeting these costs in their present housing unit, or in another unit if they move."
> (Canadian Council on Social Development, 1979, p.2)

A shelter allowance program, it should be noted, is not a housing supply program. It does not directly assist in the construction of new housing units. Shelter allowances distribute rent subsidies to households using the existing housing stock.

It is the proposal to implement a national shelter allowance program which is discussed here. A few provinces have small scale shelter allowance programs aimed mainly at the elderly. These have a much more limited impact on the housing market than a full scale national program would have.

1. THE NATURE OF THE RENTAL HOUSING SITUATION

There are three interrelated problems with the rental sector.

(1) The gap between affordable rents and existing rents.

Many low and moderate income households cannot find affordable accommodation in the private rental sector. Though the definition of affordability varies from study to study, it is generally agreed that a substantial minority of tenants find themselves having to spend an unreasonable amount of their household income on rent. CMHC 's most recent estimate is that, as of 1980, about 18 percent of tenant households, close to 500,000, have an affordability problem.

(2) The gap between existing rents and financial recovery rents.

Financial recovery rents (sometimes referred to as "economic rents") are the rent levels necessary to make new construction profitable in the absence of any government supply subsidies. They are the rents which must be charged in order to make private rental investment attractive. A serious part of the current rental problem is that the gap between the rents tenants are either able or willing to pay, the existing rents, and the rents necessary to build new units on a profitable basis, financial recovery rents, has become very large in most of Canada's major urban areas. This gap means that non-subsidized rental investment is virtually impossible in the major urban areas. The private market can, at best, supply new units for only the small percent of higher income tenants. Whereas average existing rents in the larger metropolitan areas such as Toronto and Vancouver are in the $500 to $600 range for an average two bedroom unit, the rents necessary to finance new rental projects are estimated to be closer to the $800 to $1,000 range.

(3) Persistently Low Vacancy Rates.

Vacancy rates have been extremely low for some time, well before the gap between existing rents and financial rents became as large a problem as it currently is. New supply of rental units has been a persistent problem for many decades, due to problems internal to the rental market itself (such as inelasticity of supply) and due to problems external to the rental investment market (such as high financing costs and the cost and availability of properly zoned sites). Supply has not been able to match demand where and when it was needed on a very efficient basis.

One can find general agreement on this definition of the rental problem. For example, the recent Clayton/HUDAC study, A Longer Term Rental Housing Strategy, begins with the identification of the first two problems. The report states that the current problems in Canada's rental market are:

> "Affordability Problems - a significant proportion of the renter population cannot afford adequate accommodation on the private rental market and there is an insufficient stock of subsidized housing to accommodate all of those in need of assistance; and
>
> Low levels of new rental housing production and resulting tight rental markets - for a variety of reasons, the construction of new rental housing is not a viable economic proposition in most rental markets in Canada today unless subsidies are provided to allow the economic rents on these projects to be competitive with the relatively low prevailing market rents."
>
> (Clayton/HUDAC, 1984, p.3)

The vacancy issue issue is one of those problems which never seems to go away, generally defying conventional explanations. Jones, for example notes that:

> "The most disturbing symptom of potential market imperfections has been extended periods of extremely low vacancy rates in many Canadian rental housing markets .... [S]ome of the very low vacancy rates observed are out of the range of credible natural rates; if not a product of market failure in the rental housing market these must reflect externally imposed constraints on the rental market." (Jones, 1983, p.53)

Rather than finding a great deal of disagreement over the definition of the nature of the problem, the disagreement arises over defining the cause of these problems and, therefore, the solution. Why do we have these serious problems in the rental sector?

The disagreement appears to be based largely on one's interpretation of the role of the rental market itself: is the rental market mechanism the problem or is it the solution? Are the problems we are now experiencing temporary aberrations or are they long term structural problems which have been building up over the past many years?

The possibility that the cause of the problem is the inability of the rental market mechanism to function normally is rarely explicitly questioned or debated. Instead, conventional economic analysis treats rental housing as a fairly straightforward market commodity and the rental

market a fairly straightforward commodity market. Supply and demand are not currently in equilibrium. The reason why is, to some, all to obvious. Rent controls have dramatically messed up the rental market. Government policy is not letting the market be a market. The solution is equally obvious: abolish rent controls and the rental market will, eventually, return to "normal."

2. THE SHELTER ALLOWANCE PROPOSAL: PAST AND PRESENT

Before examining this package, it is useful to glance back into recent history. Serious consideration of a shelter allowance program is not new to Canada. There was a great deal of discussion in the late 1960's and early 1970's.

In 1969 the federal government rejected a proposal by Health and Welfare for a universal shelter allowances as part of a Federal Income Security Plan. The shelter allowance proposal was rejected because the provinces did not have rent control systems and it was feared that all or a large part of the shelter allowance would be absorbed by increased rents without a comparable increase in the quality or quantity of housing consumed by recipients of the shelter allowance.

Though the shelter allowance proposal was dropped from the Federal Income Security Plan, it resurfaced in the report of CMHC's 1972 Low Income Housing Task Force, Programs in Search of a Policy (Dennis and Fish, 1972). This study recommended shelter allowances combined with a housing supply program based on socially mixed non-profit housing, as a replacement to the public housing program. Shelter allowances were recommended as a temporary measure in lieu of the government's decision not to adopt a broader incomes policy at that time.

> "A shelter allowance would serve as an interim, less expensive measure [than a guaranteed annual income], to be meshed in the future with a general income maintenance program. It would consist of a federal contribution toward shelter costs, aimed at reducing shelter-to-income ratios for all households....It would attempt to bridge the gap between ability to pay and housing costs." (Dennis and Fish, 1972, p.354)

The reports's major proposal for preventing future affordability problems for low and moderate income tenant households was the non-profit housing supply program: construction of one million non-profit units over the next (now past) decade. About 50,000 units were to be built per year leading to a stock of about 1.4 million units. In addition to meeting social needs and creating a stock of permanently affordable housing, the aim was to help slow down the rate of housing price inflation, thereby decreasing the need for rent controls.

There is more than just some irony here. When the macro economic conditions were favourable, when government finances were in better shape and when housing market conditions were generally conducive to a potentially successful implementation of a major national rental housing initiative, including shelter allowances, they were rejected. Among the opponents were the same interests and lobbies who today are the prominent advocates of shelter allowances.

When shelter allowances were first seriously advocated, they were promoted as part of a package of social welfare measures and they were opposed on the grounds that they would have a detrimental impact on the housing market. CMHC, for example, believed that they would be inflationary, driving up rent levels and, in general, have little real impact on shelter cost burdens. Shelter allowances are now being advocated as a "market welfare" measure, as part of a package which is supposed to restore the private rental market mechanism. They are not being approached as part of incomes policy and as part of a broader concern over income distribution in general.

In short, the earlier proposals for shelter allowances came essentially from the redistributive position, whereas the most recent proposals come from concerns about the private market mechanism -- an advocacy of shelter allowances as part of a package which could help justify the phasing out of provincial rent controls in order to attempt to create market conditions more conducive to restoring the private rental supply mechanism. While groups such as social welfare agencies supported shelter allowances in the early 1970's they generally oppose it today. And while development and real estate interests generally opposed the option ten years ago, they are the major advocates today.

It is the widening gap between existing rents and financial recovery rents which appears to have led some housing analysts as well as the housing industry lobby to advocate both rent decontrol and shelter allowances. The argument is quite clear:

> "To stimulate new private rental construction, either market rents must rise substantially or government subsidies for rental investment must be greatly increased - the removal of rent controls is a prerequisite to a speedy increase in market rents.
>
> The most appropriate longer-term solution to the problems of the rental market consists of (a) allowing market rents to rise to the level necessary to encourage private rental investment; and (b) implementing a program of shelter allowances to ensure that low and modest-income families have access to adequate rental accommodation at rents they can afford."
>
> (Clayton/HUDAC, 1981, p.i)

This "market welfare" position defines the role of government as one of assisting the operation of the private sector. Programs and policies are judged in terms of whether they assist or hinder the operation of the market. The distributional impacts, especially the income redistribution implications, are not a concern.

The recent Economic Council of Canada position on shelter allowances is another example of this "market welfare" housing policy campaign. The Council sees the need for major rent increases in order to reverse the current situation with respect to economic rents and market rents.

> "Rent increases would help to resolve the availability problem for apartments, but low- and moderate-income renters would be hit hard, making it more difficult for them to afford adequate housing. One way out of such a dilemma would be to cushion the impact of rent increases with a shelter allowance equal to some proportion, say 50 to 75 per cent, of the excess of monthly rent over 30 per cent of income." (E.C.C, 1982, p.49)

From this perspective, shelter allowances are viewed as an essential part of a strategy which attempts to restore an active private rental housing supply sector. A shelter allowance program would be used to help justify the elimination or softening of rent controls, allowing market rents to increase.

3. HOW FEASIBLE IS THE SHELTER ALLOWANCE/RENT DECONTROL OPTION?

The shelter allowance/rent decontrol policy package depends upon the private rental market functioning as an efficient commodity market. How likely is this?

(1) The Feasibility of Abolishing Rent Controls.

How likely is that all or most of the provinces will abolish their rent controls systems? Not very. Ontario appears to be one of most unlikely. Nova Scotia and Saskatchewan have recently expanded their rent control systems. Only Alberta and British Columbia do not have controls. Alberta appears to be in a long term recession with overbuilding in the residential sector in the boom years and very low rental demand ever since. It is questionable how long British Columbia will be without controls, due to the speculative impact of Expo 86 on rents in Vancouver or if there is a change of government at the next provincial election. The advocates of the shelter allowance/rent decontrol package need to face these political

realities. Why seriously advocate a policy package, part of which is so obviously not feasible? Whether we like it or not, the current political realities mean that rent controls may be with us for a very long time.

(2) The Affordability of Financial Recovery Rents.

The estimate that about 18% of Canada's tenants have affordability problems is based on comparing existing rents to household incomes. The existing rents, in most all cases in 1980, were rent controlled. The gap would be much larger with more households falling into the category of having affordability problems if rent controls did not exist. How affordable would decontrolled rents be to tenant households and how many tenants could afford rent levels approaching financial recovery rents? These estimates have yet to be compiled. They must take into account the impact of long term unemployment and underemployment, which will likely be increasing the affordability problem. This means that a shelter allowance program would be extremely expensive making it difficult to implement in a time of fiscal restraint and that tenant pressures for maintaining, if not expanding, rent controls would become very strong.

(3) The Cost of a National Shelter Allowance Program.

Careful cost estimates have yet to be carried out, even though shelter allowances have been seriously advocated for at least the past five years. They are, in fact, very difficult to calculate. Like unemployment insurance and welfare, macro-economic conditions will affect annual expenditures in addition to the host of eligibility criteria which would need to be worked out. Current cost estimates seem to use 1980 and 1981 data. In addition, the dollar value of the gap between existing rents and ability to pay (the affordability gap for a household) has been based on rent controlled rental levels. The gap, and therefore the cost, will be much greater if rent controls were abolished. There is also the question of administrative costs. What measures will be taken to supervise both tenants and landlords under the program? It is very costly to monitor a large scale national program. In addition to tenants finding ways to cheat, there is the problem of the rents charged by landlords. The U.S. Housing and Urban Development found that landlords were charging an average 24% more for their units in which the Section 8 rent supplement subsidies applied than the rest of their equivalent units. This form of cheating alone cost the U.S. rent supplement program an estimated $213 million extra in 1980. (Abt Associates, 1981, pp. S-13, S-14) Shelter allowances make the most sense in combination with rent regulated markets with a rent registry in place. Supervision becomes much easier and less costly.

(4) How Much Will Non Subsidized Rental Supply Increase?

In terms of rental market impact, shelter allowances are supposed to assist in stimulating demand, which should result in increased supply. However, the low-income households which would receive the subsidy compete

for units in the low-cost sub-market, which suppliers simply cannot build for. There is already tremendous unmet demand in this submarket. In addition, low income households have problems affording other goods and services beside accommodation. Not all of the shelter allowance will be spent on shelter. This is a very indirect and inefficient means of stimulating new supply. Even the advocates of the package admit that non-subsidized private supply will only come about in the long term and that, in the short term, rental supply subsidy programs will still be needed in addition to the shelter allowance program. That supply will increase in the long term is based on the assumption that the private rental market mechanism will eventually function normally. This assumption, however, is based purely on theories about ideal markets and faith, not on any reliable, objective assessment of current and likely future conditions.

(5) Will Rent Inflation Result?

A fundamental objective of the package is rent inflation. This is why it is difficult to foresee how low income tenants will be any better off for having received the shelter allowance. The allowance they receive must be transferred to their landlords due to higher rents. They will, at best, remain in the same position. All other tenants will be worse off. The justification for this, it is argued, is that, in the long term, an efficient private rental market in equilibrium will leave all tenants better off. In the short term, however, it is much more probable that there will be a great deal of political opposition. People live in the present, not in the long term.

(6) Who Will Qualify for a Shelter Allowance?

The number who should qualify will be increasing due to the abolition of rent controls, general inflationary pressures on the housing sector, and unemployment and underemployment problems. Yet few programs for the poor are adequately funded and even fewer adequately adjust subsidy levels on an annual basis to keep pace with rising costs. In addition, it is generally agreed that a shelter allowance would have to be phased in over some undefined period of time. Under these practical financial and political constraints, it is even more difficult to see how lower income tenants will be any better off under this package. It is easy to see how many will, in fact, be much worse off due to the inevitable rent inflation. In terms of political feasibility, therefore, it is unlikely that much of a coalition will ever emerge in support of the shelter allowance/rent decontrol package.

In terms of feasibility, therefore, it would appear that the "market welfare" version of shelter allowances, tied as it must be to rent decontrol, in order to try and achieve a "normal" rental market mechanism, is not a very feasible option. There are severe political constraints as well as financial constraints. The advocates have offered little evidence

that the market welfare scenario would even in fact come about if their package was implemented. It relies on conventional theories about markets and assumes that the rental sector of the 1980's and beyond can function as a normal commodity market.

4. HOW DESIRABLE IS THE SHELTER ALLOWANCE/RENT DECONTROL OPTION?

Would this scenario be socially desirable if it was feasible? The type of "allocative efficiency" achieved by normal markets is not always a wholly satisfactory achievement. Exclusive reliance on markets, even when they are performing relatively efficiently in an economic sense, can lead to the neglect of other goals that may be important to society. A particular "efficient" allocation of resources by the market will usually only by accident be in accordance with most people's sense of what is just or fair. A major example is income redistribution. The actual distribution of income in a freely functioning competitive market system reflects its past: it tends to perpetuate inequalities in the distribution of income and the ownership of assets. This leads to concerns over the kind of equity the market mechanism achieves.

The host of problems with the shelter allowance/rent decontrol package raises numerous questions about equity: who, in the end, will benefit from such a proposal? The proposal places a great deal of faith in conventional theories about markets and seems to ignore both the past and present realities of how the rental market has actually performed.

If the package was politically and economically feasible, it would not be socially desirable. Huge sums of money would be gambled on the assumption that the private rental market mechanism can be the solution to our problems. In the short run, such a proposal would certainly be a massive transfer of wealth to the owners of existing rental accommodation from the taxpayers who would finance this program, to the tune of at least $1 to $2 billion annually. In addition, all tenants would collectively transfer even more through higher rents. If the rental market, in the long term, does not achieve "allocative efficiency" and a socially acceptable level of equity, as is predicted by the advocates, the cost of correcting the situation would be even greater and we would be in a much worse rental mess than we are now.

There has been little attempt thus far to offer hard evidence as to the probability of this market welfare scenario working. We are essentially being told to have faith and to believe that it will come to pass. The most recent articulation of the shelter allowance/rent decontrol package, for example, ends with the following statement:

> "The argument in favour of shelter allowances _is based on a belief_ that the private rental market can operate effectively _if_ it is allowed to do so."
> (Clayton/HUDAC, 1984, p. C-12, emphasis added)

To my mind this is a "utopian capitalist solution." It is based more on ideology, a belief in a supposed ideal, rather than on a practical and realistic assessment of the conditions and constraints of the 1980's and beyond.

Part of the rental problem is an incomes problem, people simply cannot afford housing suitable to their needs. These households, however, also have problems affording other essential goods and services as well. Is it not reasonable to address an incomes problem with an incomes program? The administrative mechanism already exists and it is simply a problem of current underfunding.

Part of the rental problem is also a supply problem, affordable rental units are not being supplied. Is it not reasonable that we address the supply problem with supply programs? This would directly address the problem and have few if any of the negative impacts of the indirect approach -- that is, through a demand subsidy, the shelter allowance program, and rent decontrol.

The shelter allowance/rent decontrol package fails to recognize the cause of the problems of the rental sector. It does recognize the the general nature and scope of the problems but it proposes to do more of the same kind of thing which helped create the mess we are in. It is a proposal which, in fact, would compound the problem at great financial cost and with few real social benefits.

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